



RETURN RECEIPT REQUESTED

M-60749
(922.B)

JAN 19 1990

CERTIFIED--RETURN RECEIPT REQUESTED

DECISION

ARCO Oil and Gas Company)
Attention: Ronald T. Sponberg)
P. O. Box 1610)
Midland, Texas 79702)

SDR NO. 922-90-02

Reversed

ARCO Oil and Gas Company has requested a State Director Review (SDR) of a decision of the District Manager, Miles City District Office (MCDO), Miles City, Montana, dated December 12, 1989, assessing compensatory royalties for drainage from Federal oil and gas lease M-60749. Said drainage occurred as a result of production from the Hoffelt No. 2 well located in the SE1/4SW1/4, sec. 32, T. 32 N., R. 59 E., Sheridan County, Montana. The request for this SDR was dated January 8, 1990, and was timely received by this office on January 16, 1990.

ARCO identified several technical and procedural issues for consideration by this SDR. One issue concerned the economic analysis prepared by the MCDO showing that a paying protective well could have been drilled on the drained tract. ARCO stated on page 2 of their SDR that, "...the Miles City Office has chosen to increase its crude oil price forecast to near double the original forecast used by the Miles City Office in its economic analysis which ARCO received on June 17, 1986." ARCO further stated that, "...the more precise and accurate measure of the projected economic performance of the 'protection' well in this instance is actual historical pricing data."

The paying well analysis prepared by the MCDO on December 7, 1989, follows the example provided in the Interim Drainage Standards Handbook (H-3160-2), in that it assumes level pricing from the date that a paying protective well could have first been drilled. However, page 16 of the Interim Drainage Manual (3160-2) states that, "The value for oil and gas pricing is based on the appropriate time period...." We recognize that this may represent an apparent contradiction, but it is our position, when data is available, historical pricing will be used when conducting paying well determinations. Therefore, we conducted a new protective

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well analysis using the same variables as those used by the MCDO, except that we substituted historical prices per barrel of oil instead of constant 1985 prices (see enclosed). The results of this analysis showed that a prudent operator could not have drilled a paying protective well when historical prices were used. Consequently, we hereby reverse the December 12, 1989, decision of the MCDO, and cancel the accompanying compensatory royalty assessment against ARCO.

Please contact this office at 406-255-2857 if you have any questions concerning this decision.

/s/ Thomas P. Lonnie

1 Enclosure

1-Protective well analysis (1 p.)

cc: w/enclosure
DM, Miles City

bc: (w/o encl.)

CA SO
NM SO
AK SO
AZ SO
ESO
WY SO
ID SO
NM SO
OR SO
UT SO
NV SO

922:EBurks:jk:1/18/90:x844:6017d